



CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

June 22, 2006

H.R. 4019

A bill to amend title 4 of the United States Code to clarify the treatment of self-employment for purposes of the limitation on state taxation of retirement income

As ordered reported by the House Committee on the Judiciary on June 7, 2006

H.R. 4019 would amend current law (Public Law 104-95) to prohibit state taxation of certain retirement income of former residents. The legislation would specifically limit the ability of states to tax the retirement income of nonresidents who were partners in firms domiciled within a state. These provisions could result in some individuals having lower itemized deductions of state income taxes on their federal income tax returns and, therefore, higher federal income taxes. Under the assumption that, in the absence of this legislation, states would continue to tax certain retirement income of former residents, CBO estimates that enacting this bill would result in an increase in federal income taxes of less than \$500,000 per year, totaling about \$1 million over the 2007-2016 period. CBO estimates that H.R. 4019 would have no significant impact on federal spending.

The prohibition on taxing the income of certain retirees would constitute an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA) because it would preempt the authority of states to tax. Since UMRA includes in its definition of the direct costs of a mandate amounts that state and local governments would be prohibited from raising in revenues, the cost of this mandate would include the amounts that states are currently collecting but would be precluded from collecting under H.R. 4019. Based on information from the states and some of the affected partnerships, CBO estimates that the net costs to state governments would likely total less than \$5 million annually and thus would not exceed the threshold established in UMRA (\$64 million in 2006, adjusted annually for inflation) in any of the first five years after enactment.

Under current law, there is some uncertainty as to the taxability of the income of retired partners who do not currently live in the state where they initially earned that income. Only one state, New York, has issued rules that require retired partners to pay such taxes, and those rules are currently being challenged in court. At least 15 other states report that they currently collect tax on such revenues although they are not actively auditing or pursuing

partners or companies who are not remitting these taxes. It is unclear if other states currently collect such tax or would do so in the next five years in the absence of legislation.

In total, CBO estimates that actual state tax collections that would be affected by this legislation total less than \$10 million annually. Many retired partners who pay taxes to states where they do not currently live receive credit for those taxes in the state where they do live. Such credits would partially offset these losses, resulting in a net impact across all states totaling less than \$5 million annually.

The bill contains no private-sector mandates as defined in UMRA.

The CBO staff contacts for this estimate are Barbara Edwards (for federal revenues), and Sarah Puro (for the state and local impact). This estimate was approved by Peter H. Fontaine, Deputy Assistant Director for Budget Analysis, and G. Thomas Woodward, Assistant Director for Tax Analysis.